No. 177

In the Supreme Court of the United States

October Term, 1956

FRANCES E. LATENDRESSE, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

BRIEF FOR THE RESPONDENT IN OPPOSITION

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BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 65-84) are reported in 26 T.C. 318. The opinion of the Court of Appeals (Pet. 13-20) is reported in 243 F. 2d 577.

JURISDICTION

The judgment of the Court of Appeals was entered on April 30, 1957. (Pet. 13, 20.) The taxpayer's petition for rehearing was denied on May 25, 1957. (Pet. 2.) The petition for a writ of certiorari was filed on July 15, 1957. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTION PRESENTED

Under the will of her husband, who died in 1944, the taxpayer acquired her husband's rights to renewal commissions pertaining to insurance policies written by him, and also her husband's rights, acquired by assignment, to renewal commissions pertaining to insurance policies written by others.

The question is whether such renewal insurance commissions received by the taxpayer during the taxable years 1946 through 1949 should be included in her gross income for those years as "income in respect of a decedent", under the provisions of Section 126(a) of the Internal Revenue Code of 1939.

STATUTE INVOLVED

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

* * * * * * * * *

(b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

* * * * * * * * *

(3) [As amended by the Revenue Act of 1942, Section 111(a), c. 619, 56 Stat. 798] *Gifts, bequests, devises, and inheritances.*—The value of property acquired by gift, bequest, devise or inheritance.

* * * * * * * * *

(26 U.S.C. 1952 ed., Sec. 22.)

SEC. 126 [As added by the Revenue Act of 1942, Section 134(c), c. 619, 56 Stat. 798]. INCOME IN RESPECT OF DECEDENTS.

(a) *Inclusion in Gross Income.*—

(1) *General rule.*—The amount of all items of gross income in respect of a decedent which

are not properly includible in respect of the taxable period in which falls the date of his death or a prior period shall be included in the gross income, for the taxable year when received, of:

* * * * * * * *

(3) *Character of income determined by reference to decedent.*—The right, described in paragraph (1), to receive an amount shall be treated, in the hands of the estate of the decedent or any person who acquired such right by reason of the death of the decedent, or by bequest, devise, or inheritance from the decedent, as if it had been acquired by the estate or such person in the transaction by which the decedent acquired such right; and the amount includible in gross income under paragraph (1) or (2) shall be considered in the hands of the estate or such person to have the character which it would have had in the hands of the decedent if the decedent had lived and received such amount.

* * * * * * * *

(26 U.S.C. 1952 ed., Sec. 126.)

STATEMENT

The pertinent facts, including by reference (R. 74) the facts (plus exhibits) stipulated by the parties (R. 18-56), were found by the Tax Court (R. 66-73) and adopted by the court below (Pet. 14-17), substantially as follows:

The taxpayer is the widow and sole beneficiary under the will of Frank J. Latendresse (hereafter called the decedent) who died July 3, 1944. The decedent became connected with the insurance business of the Standard Life Insurance Company of Indiana (to be called Standard) through several contracts hereinafter described. (R. 66, 70, 72.)

Standard was organized in 1934 by Arthur H. Wyatt and George F. Flagg for the purpose of carrying on a life insurance business. Wyatt was designated as Standard's general agent for the sale of certain capital stock of the company and life insurance policies denominated "organization policies", in an aggregate amount of $15,000,000. Wyatt employed Flagg to assist him in the performance of these contracts. (R. 66.) Under date of February 28, 1939, Wyatt entered into a contract with the decedent (hereinafter referred to as the A Agency Contract), under which Wyatt sold the decedent the unperformed part of the former's contracts of July 19, 1934, and September 18, 1937, with Standard. (R. 20-23, Exs. 2(f) and 2(g).[1]) The consideration given Wyatt was $23,000, of which $3,000 was contributed by Flagg, and $3,860.34 was assigned as the purchase price of the tangible assets. This sale did not include the deferred or contingent renewal commissions on insurance and stock already sold. These contingent sums were impressed with a trust for the payment of existing obligations of the agency. The decedent was substituted for Wyatt as the general agent of Standard to sell the remainder of the $15,000,000 of life insurance. (R. 66-67.)

On April 22, 1940, the decedent and Wyatt made another contract (referred to as the A Agency Renewal Contract). (R. 20, 40-41; Ex. 5.) The Tax Court found that, under this contract, the decedent purchased from Wyatt for a total consideration of $12,500[2] the latter's interest in the contingent

[1] The commissions and renewal commissions were to be payable to Wyatt for a period of 15 years. (R. 66.)

[2] The consideration cited in the contract was $10,500 but, as the Tax Court stated (R. 67), the parties stipulated the cost to be $12,500 (R. 56).

renewal commissions, retained by Wyatt in 1939, in excess of the amounts necessary to satisfy the several obligations for which these contingent sums had been impressed with a trust pursuant to the A Agency Contract. (R. 67.)

On April 19, 1939, Standard entered into a contract with the decedent's brother, James (referred to as the B Agency Contract). (R. 20, 23-24; Ex. 3.) Under this contract, James was appointed general agent for the sale of additional capital stock and also certain insurance policies denominated "Special Coupon Policies," to begin upon the completion of the then-existing contract between Standard and the decedent. This agreement was amended on May 21, 1939, to provide for the substitution of the decedent as general agent in the event of the death of James. The decedent agreed to advance up to $30,000 for the purpose of financing the sale of the new policies, in consideration of which he was to receive 24 per cent of the net proceeds of such business in addition to repayment of the amounts advanced. Flagg was employed under this contract to assist in the sale of these policies, for which he was to receive 32 per cent of the net proceeds of the business, and was named as successor to the general agency upon the death of both James and the decedent. James died on May 11, 1940, and the decedent was then substituted as general agent. On December 31, 1941, Flagg sold his interest in the B Agency Contract for $7,400.63 to the decedent who was the sole owner of that contract at the time of his death in 1944, and no portion of the commissions belonged either to Flagg or to the estate of James. (R. 67-68.)

On May 20, 1931, the decedent entered into a new contract with Standard (referred to as the "Agency Contract). (R. 21, 24-28; Ex. 6.) Under this new contract the decedent was to act as its general agent in the sale of certain life insurance policies known as "Profit-sharing Participating Thirty-payment Life" policies. He was to receive as consideration for the sale of the insurance policies 85 per cent of the first year's premiums, 12½ per cent of the premiums for the next five years, 7½ per cent of the premiums for the next four years, and 5 per cent of the premiums for the next five years, plus certain bonuses payable out of the first annual premiums. Each party was to advance funds equal to those furnished by the other up to $20,000 each to finance the operations of the general agency during the first year. (R. 68-69.) This contract further provided in pertinent part that the amount of money furnished by Standard was to be secured solely by the renewal commissions payable thereunder to the decedent, except that during the actual operation and performance thereof only 50 per cent of the renewal commissions were to be applied upon the funds furnished by the Company, and the remaining 50 per cent thereof would be payable to the decedent. If performance under the contract should terminate, however, then the whole of such renewal commissions were to be applied against the funds furnished by the Company, but the decedent was not to be personally liable to repay to Standard any of the funds furnished by it. The contract provided further, moreover, that no partnership relationship was created thereby, and that Standard, by furnishing the funds as provided therein, would acquire no interest in the business enterprise to be conducted by the

decedent under the contract, except that it would be entitled to receive repayment of the funds furnished by it out of the renewal commissions, as above stated. (R. 26, 69.)

Standard had advanced $10,235 up to the date of the decedent's death in 1944. That amount was carried as a liability of the general agency and was so treated on the estate tax return of the decedent. Standard credited $7,441.77 during the year 1946 from renewal commissions due the taxpayer in repayment of its advances. (R. 69.)

The decedent entered into an agreement with John N. Brown on May 20, 1941 (R. 21, 42-49; Ex. 6), whereby Brown was employed for the purpose of assisting in the carrying out of the C Agency Contract. Brown was to receive 50 per cent of the net profits as compensation. The agreement further provided for the succession by Brown to the general agency upon the death of the decedent. Brown, in such event, was to pay the decedent's widow, the taxpayer here, 50 per cent of the net profits, less one-half of the bookkeeping and disbursement expenses, for all insurance sold up to the date of succession. Brown succeeded to this general agency upon the decedent's death on July 3, 1944. (R. 69-70.)

The duties of the decedent as general agent for the C Agency, under the supplemental agreement with Standard dated June 5, 1942 (R. 21, 28-38; Ex. 7), were that he was required to procure agents to enter into contracts with Standard, solicit applications for insurance and annuities with the Company either personally or through his agents, collect, in exchange for official receipts furnished by the Company, and remit immediately to it all first-year and renewal premiums

on business written by or through his agency or transferred to it by the Company with his consent (R. 70).

Each of the above-mentioned agency contracts—of which the A and B Agency Contracts contained similar descriptions—provided that upon the happening of certain events (which were not susceptible of ascertainment) the contract could be canceled by either party and Standard could revoke the privilege therein granted. (R. 70.)

One hundred agents, formerly employed by Wyatt and Flagg, were turned over to the decedent when he entered the insurance business. All salesmen and agents engaged in selling life insurance policies were to be employed by and under the exclusive supervision of the decedent. (R. 70.)

On the basis of the foregoing facts, the Tax Court held that the renewal insurance commissions in question received by the taxpayer during the taxable years involved are chargeable to her as ordinary income, within the meaning of Section 126(a)(1) and (3) of the Internal Revenue Code of 1939. (R. 74-78, 80-81.) The court below affirmed. (Pet. 17-20.)

ARGUMENT

The problem presented in this case concerns the application of Section 126 of the Internal Revenue Code of 1939, and is similar to the problem presented in *Commissioner* v. *Linde*, 213 F. 2d 1 (C.A. 9th), certiorari denied, 348 U.S. 871. The decision in the present case is in full accord with the Ninth Circuit's decision. Since the denial of certiorari in that case, there have been no intervening appellate court decisions, nor does there appear to be any other compelling reasons why the problem should now be reviewed by this Court.

In *Helvering* v. *Enright*, 312 U.S. 636, which arose under Section 42 of the Revenue Act of 1934, c. 277, 48 Stat. 680,[3] this Court held that the share of a deceased member of a law firm in the estimated receipts from the unfinished business of the firm, valued as of the date of his death, should be included in computing his income for the period in which fell the date of his death.

The provision of the Revenue Act of 1934 which was involved in the *Enright* case resulted in hardship in some cases where amounts which would have been received over a number of years were returnable in the year of death, thus carrying the income into the higher brackets. To alleviate this hardship, Section 126 of the 1939 Code was added (and Sections 42(a) and 43 were amended) by Section 134(c) of the Revenue Act of 1942, c. 619, 56 Stat. 798, to provide that income accruing to a decedent because of his death was not includible in his final return, but was to be treated as income and reported as income by the one receiving the right to such income. Such treatment was for the express purpose of alleviating a hardship, and at the same time preventing income in respect of decedents from escaping taxation. H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 83-88 (1942-2 Cum. Bull. 372, 435-439); S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 100-105 (1942-2 Cum. Bull. 504, 579-583).

In the present case, the decedent performed services and as a consequence acquired the right to renewal

[3] Section 42 of the Revenue Act of 1934 was enacted because the courts had held under prior law that income accrued by a decedent on the cash basis prior to his death was not income to the estate but a part of the corpus. *See Helvering* v. *Enright*, 312 U.S. 636, 639. Hence, prior to the Revenue Act of 1934 neither the estate nor the decedent paid income tax on such income.

insurance commissions extending over a period of approximately 15 years. When the decedent's widow succeeded to his rights in these renewal commissions, she was required by the express terms of Section 126 (a)(3) of the 1939 Code to treat them as if she had acquired them in the same transaction by which the decedent had acquired such rights. Since the decedent would have been compelled to treat the renewal commissions, had they been received by him, as ordinary income arising from services rendered, it would seem apparent that this is the clearest kind of case falling within the purview of Section 126.

With respect to the renewal commissions which the decedent acquired by assignment, there would have been nothing more for him to do had he lived, but to have received the money. And had he received the payments, they would have been taxed to him as ordinary income. *Cottle* v. *Commissioner*, 228 F. 2d 186 (C.A. 2d). By virtue of the terms of Section 126, the taxpayer stood in the shoes of the decedent when she received these payments, and hence the payments similarly would constitute ordinary income to her.[4] *Estate of Remington* v. *Commissioner*, 9 T.C. 99, taxpayer's appeal dismissed, November 9, 1948 (C.A. 2d); *Commissioner* v. *Linde*, 213 F. 2d 1 (C.A. 9th), certiorari denied, 348 U.S. 871; *O'Daniel's Estate* v. *Commissioner*, 173 F. 2d 966 (C.A. 2d); *Estate of Narischkine* v. *Commissioner*, 14 T.C. 1128, affirmed *per curiam*, 189 F. 2d 257 (C.A. 2d); *Bausch's Estate* v. *Commissioner*, 186 F. 2d 313 (C.A. 2d).

[4] The decedent would have had the right to recover amortization of the consideration he had paid for property, and likewise the taxpayer is entitled to have allowance made for any unrecovered cost. Both courts below have made such allowance (R. 78-80; Pet. 19), and no question is raised in the petition with respect to this allowance.

The taxpayer's chief reliance (Pet. 3, 7) in this Court is upon the decision in *Hartley* v. *Commissioner*, 295 U.S. 216. That case involved the question of the basis for computing gain or loss on the sale of property by the decedent's estate. The decision there was handed down in 1935, seven years prior to the passage of the statute here involved and has, we believe, no bearing whatsoever on the present problem. Section 22 (b)(3) of the 1939 Code, adverted to by the taxpayer (Pet. 4 *et seq.*), would have been applicable only in a situation where the decedent, had he lived, would have been forced to alter the then-existing contractual relationships in order to have himself realized the income. Here, the existing contractual relationships required the payments to be made to the decedent, and nothing further was required of him to close the transactions for the realization of ordinary income. Section 22(b)(3) is a general statute which yields to the specific treatment provided in Section 126. *Hellmich* v. *Hellman*, 276 U.S. 233.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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